2006

If Only Most Americans Understood

Henderson, David R.

Wall Street Journal

Henderson, D. If Only Most Americans Understood. Wall Street Journal, 2006.
http://hdl.handle.net/10945/61544

If Only Most Americans Understood

Henderson, David R . Wall Street Journal , Eastern edition; New York, N.Y. [New York, N.Y]01 Aug 2006: A.12.

ABSTRACT (ABSTRACT)

"The Right Minimum Wage: $0.00." So read an editorial headline in one of the most respected newspapers in America. The editorial stated: "There's a virtual consensus among economists that the minimum wage is an idea whose time has passed. Raising the minimum wage by a substantial amount would price working poor people out of the job market." Can you guess the newspaper? The Wall Street Journal, perhaps? Right city; wrong paper. This editorial appeared on Jan. 14, 1987, in the New York Times.

Economists' consensus estimate is that a 10% increase in the minimum wage would destroy 1% to 2% of youths' jobs. A federal increase to $7.25 would, therefore, destroy about 800,000 to 1.6 million youths' jobs. Some older low-skilled workers would also suffer. And the hurt to youths isn't just short-term, according to economists David Neumark of the University of California, Irvine, and Olena Nizalova of Michigan State University. In a 2004 National Bureau of Economic Research study, they found that even as people reached their late 20s, they worked less and earned less the longer they had been exposed to a higher minimum wage, especially as teenagers.

Couldn't a job loss of 1% to 2% be worth it, if the remaining 98% to 99% get a wage increase? This isn't the tradeoff, for two reasons. First and most important, the majority of youths are already earning more than the higher minimum that is typically proposed. For instance, in a study of a proposed minimum-wage increase in California from to $7.75 from $6.75, economist David A. Macpherson of Florida State University and Craig Garthwaite of the employer-funded Employment Policies Institute found that of 1.48 million California youths with jobs, 79% earned a wage higher than $7.75, and there's no guarantee that these workers would get an increase. Some, but probably not most, would get what are called "spillover benefits" because of the new pressure on the wage structure.

FULL TEXT

"The Right Minimum Wage: $0.00." So read an editorial headline in one of the most respected newspapers in America. The editorial stated: "There's a virtual consensus among economists that the minimum wage is an idea whose time has passed. Raising the minimum wage by a substantial amount would price working poor people out of the job market." Can you guess the newspaper? The Wall Street Journal, perhaps? Right city; wrong paper. This editorial appeared on Jan. 14, 1987, in the New York Times.

More recently, the Times has called for further increases in the minimum wage. At the federal level, many Democrats and some Republicans are pushing to raise the minimum wage from its current level of $5.15 an hour. Moreover, initiatives on the ballot in 10 states would increase the minimum wage.

Most people see the issue as a no-brainer. Wouldn't it be nice to raise the wages of the lowest-earning people? Even if they understand that this will cause them to pay higher prices on goods and services, they see that as a worthwhile price to pay. But economists of various political stripes tend to oppose the minimum wage. We understand that it will help only a subset of the people it is thought to help, and will help them only a little -- while hurting some of them a lot.

The reason goes back to the second sentence quoted in the above Times editorial. In raising the minimum wage, the government doesn't guarantee jobs. It guarantees only that those who get jobs will be paid at least that minimum. But precisely by requiring this, the government destroys jobs. Someone to whom an employer was willing to pay only the current minimum wage of $5.15 might not produce enough to be worth paying, say, $7.25.

It's not all or nothing. Some of the workers currently earning $5.15 would find their wages rising to $7.25. But the marginal tasks, the least important tasks in the workplace, would no longer be worth doing, thus costing jobs. In the longer run, employers will find more capital-intensive ways of doing these tasks.

Economists' consensus estimate is that a 10% increase in the minimum wage would destroy 1% to 2% of youths' jobs. A federal increase to $7.25 would, therefore, destroy about 800,000 to 1.6 million youths' jobs. Some older low-skilled workers would also suffer. And the hurt to youths isn't just short-term, according to economists David Neumark of the University of California, Irvine, and Olena Nizalova of Michigan State University. In a 2004 National Bureau of Economic Research study, they found that even as people reached their late 20s, they worked less and earned less the longer they had been exposed to a higher minimum wage, especially as teenagers.

These adverse longer-run effects, they found, were stronger for black teenagers. Their finding recalls the famous line from liberal economist Paul Samuelson's 1970 textbook, "Economics," about a proposal to raise the minimum to $2: "What good does it do a black youth to know that an employer must pay him $2.00 an hour if the fact that he must be paid that amount is what keeps him from getting a job?"

But couldn't a job loss of 1% to 2% be worth it, if the remaining 98% to 99% get a wage increase? This isn't the tradeoff, for two reasons. First and most important, the majority of youths are already earning more than the higher minimum that is typically proposed. For instance, in a study of a proposed minimum-wage increase in California from to $7.75 from $6.75, economist David A. Macpherson of Florida State University and Craig Garthwaite of the employer-funded Employment Policies Institute found that of 1.48 million California youths with jobs, 79% earned a wage higher than $7.75, and there's no guarantee that these workers would get an increase. Some, but probably not most, would get what are called "spillover benefits" because of the new pressure on the wage structure.

Second, because the minimum wage does not make employees automatically more productive, employers who must pay higher wages will look for other ways to compensate: by cutting non-wage benefits, by working the labor force harder, or by cutting training. Interestingly, the Economic Policy Institute (EPI), a union-funded organization in Washington that pushes for higher minimum wages, implicitly admits the last two of these three. On its Web site, EPI states, "employers may be able to absorb some of the costs of a wage increase through higher productivity, lower recruiting and training costs, decreased absenteeism, and increased worker morale." How would an employer get higher productivity and decreased absenteeism? By working the employers harder and firing those who miss work. Lower training costs? By training less.

Nor is the minimum wage a well-targeted policy for reducing poverty. The usual stereotype is of a minimum-wage parent with no other family members working. But that's a small segment of minimum-wage workers. That same EPI Web site states that 14.9 million workers would benefit from an increase in the minimum wage to $7.25, 6.6 million of whom currently earn less than $7.25 -- they assume zero job loss -- and 8.3 million of whom earn more but, they claim, get a spillover. Yet EPI admits that only 1.4 million of the 14.9 million, less than 10%, are single parents with children.

The economists' consensus about the job-destroying aspect of the minimum wage is less strong than it used to be. In the late 1970s, 90% of economists surveyed agreed or partly agreed with the statement, "a minimum wage increases unemployment among young and unskilled workers." By 2003, this percentage had fallen to 73. Still a strong consensus, but a weaker one than previously. What happened?

The answer: One major study and a book by economists David Card, now at the University of California, Berkeley, and Alan Krueger of Princeton. In a 1994 study of the effect of a minimum wage increase in New Jersey, they found higher growth of jobs at fast-food restaurants in New Jersey than in Pennsylvania, whose state government had not increased the minimum wage. This study convinced a lot of people, including some economists. It was almost comical to see Sen. Edward Kennedy hype this study when he had never before mentioned any economic studies of the minimum wage.

Based on criticism of their data from David Neumark and economist William Wascher of the Federal Reserve Board, Messrs. Card and Krueger moderated their findings, later concluding that fast-food jobs grew no more slowly, rather than more quickly, in New Jersey than in Pennsylvania. But they never answered a more fundamental criticism, namely that the standard economists' minimum-wage analysis makes no predictions about narrowly defined industries. As Donald Deere and Finis Welch of Texas A&M University, and Kevin M. Murphy of the University of Chicago, pointed out, an increased minimum wage help expand jobs at franchised fast-food outlets by hobbling competition from local pizza places and sandwich shops. This could explain, in fact, why Messrs. Card and Krueger found fast food prices rising more quickly in New Jersey than in Pennsylvania, a fact that they were unable to explain.

Even many who favor increasing the minimum wage admit it would destroy jobs. In a recent New York Times op-ed favoring a minimum-wage increase, Michael Dukakis, the 1988 Democrat candidate for president, and Daniel Mitchell of UCLA's Graduate School of Management, write, "it's possible some low-end jobs may be lost." They claim that, somehow, those who lose jobs will disproportionately be illegal immigrants.

The focused support for the minimum wage comes mainly from labor unions, all of whose members earn more than the minimum. This isn't benevolence at work, but greed. Their leaders understand that the minimum wage prices out their low-wage competition: it acts like an internal tariff. If only most Americans understood.

Mr. Henderson is a research fellow at the Hoover Institution and the co-author of "Making Great Decisions in Business and Life" (Chicago Park Press, 2006).

(See related letter: "Letters to the Editor: Who Wants to Work for $5.15 an Hour?" -- WSJ Aug. 1, 2006)